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Mr. Chairman and Members of the Subcommittee on Aviation, it is a pleasure to be here today to review the status of our Nation's domestic air transportation system in a deregulated environment. The Department of Transportation is pleased with the progress which has been made in this industry, in both the cargo and passenger sectors. The economics of air freight operations differ considerably from those involved in the transportation of passengers, and the developments in these two sectors have not been entirely parallel. On the air cargo side, we have witnessed new and expanded services, triggered largely by the increased operating flexibility and renewed opportunities for profit afforded under deregulation. In the case of air passenger transportation, we have seen tremendous growth--record traffic, load factors, and earnings--stimulated to a great extent by the wider availability of low fares. I will begin my testimony this morning with a brief review of the developments which have taken place in the freight sector of the industry since November 9, 1977, when the air cargo deregulation legislation was enacted into law. I will then turn my attention to changes which have occurred in the passenger side of the business.

Enactment of P. L. 95-163 removed virtually all of the Civil Aeronautics Board's authority over U. S. air carriers' domestic all-cargo and combination (or passenger/cargo) air freight operations. The Board no longer has the power to control air freight rates or conditions of service except to the extent that rates or rules are found to be unjustly discriminatory, prejudicial, or predatory.

P. L. 95-163 also created, under Part 418 of the Federal Aviation Act, a new class of air carrier--domestic operators of all-cargo equipment. During the first year of its effectiveness, the statute limited entry to "grandfathers," those carriers which had provided some measure of all-cargo air service in the 12 months immediately preceeding passage. As of November 9, 1978, however, entry to the industry was finally opened to "any citizen of the U. S." able to demonstrate to the CAB that it is fit, willing, and able to conduct domestic all-cargo operations. In addition, the statute removed the Board's control over market entry and exit in the all-cargo sector.

With respect to air cargo deregulation, I must emphasize that it is still too soon to draw final conclusions. In the course of oversight hearings on the issue held by the Senate Committee on Commerce, Science and Transportation on April 5, 1979, a number of factors were identified which have contributed to the industry's slow response to the new opportunities. Inherent and transitional barriers to entry or expansion in the all-cargo sector include such problems as aircraft acquisition and financing. The impact of air passenger deregulation has drawn combination carriers' attention to that--the more profitable--side of their business. And vestiges of regulatory control by the Interstate Commerce Commission continue to hamper the growth and development of an air cargo service network which is optimally responsive to the public need.

Although it is premature to draw firm conclusions, the experience to date has been generally quite positive. We are particularly encouraged by a broad range of service improvements stimulated in part by the removal of arbitrary restrictions on all-cargo operations and in part by the restored ability of carriers to rapidly adjust their rates to levels consistent with supply/demand criteria.

In the years prior to deregulation, the airline industry's inability to generate reasonable profit on domestic all-cargo operations led to substantial deterioration in the quantity and quality of air freight services available to the general public. If you will turn to Appendix 1, you will see that during the period from 1970 through 1976, the domestic all-cargo industry as a whole experienced seven years of consecutive losses on operations. As a result, two major trunk carriers, Eastern and Delta, eliminated freighter service altogether. And the Nation's two largest trunk carriers, American and United, reduced prime-time (overnight) freighter service and discontinued all-cargo operations to a number of cities. Thus, while roughly 50 U. S. cities were receiving domestic all-cargo service in the late 1960's, that figure had been cut almost in half by 1977 just before the air cargo deregulation bill was passed.

Despite the many factors contributing to the slow response of the industry, air freight service has clearly been expanded since the enactment of P. L. 95-163. Flying Tiger, for example, inaugurated scheduled all-cargo operations at nine major cities and has extended service to many smaller communities by augmenting its direct air service with a truck feeder program. Evergreen used its Part 418 authority to establish new scheduled all-cargo service along both

coasts. Pan American and Seaboard, primarily international carriers, have extended all-cargo service to a number of domestic points. And Federal Express began operating large capacity jet aircraft over routes where it had formerly scheduled up to four of its Falcons, simultaneously, in order to meet capacity demands. As detailed in Appendix 2, all-cargo capacity measured in available ton-miles operated by the domestic trunk and all-cargo carriers rose 21 percent in 1978, to its highest level since 1970.

Critics of the air cargo legislation have complained that deregulation "caused" air freight rates to rise. A fair reading of the facts, however, shows that this just isn't so. Prior to deregulation, air freight rates had been held too low to support the level of prime-time freighter operations which the market demanded. In fact, CAB Administrative Law Judge Present, in his 1975 decision in the Domestic Air Freight Rate Investigation (DAFRI), found that by 1974 regulation had depressed rates to a level roughly 40 percent below industry average freighter costs. And this was despite efficient operations at high average load factors in the all-cargo sector.

After Judge Present's important decision was issued in 1975, and prior to deregulation, the CAB permitted carriers to take periodic general freight rate increases, according to guidelines established in DAFRI, to allow rates to rise to more compensatory levels. Appendix 3 illustrates this point. It must be kept in mind, however, that costs have also been rising rapidly since 1975, necessitating continued periodic rate increases if carriers are to provide viable domestic all-cargo services.

Significantly, the general increases taken by carriers since deregulation have been substantially consistent with the CAB guidelines established in DAFRI and with the general increases taken by carriers and approved by the Board in the years just prior to deregulation. What is even more important, though, is that with the elimination of air cargo tariffs, we are beginning to see some true differentiation in price/quality service options which is the hallmark of competition. Previously, when one major carrier filed notice of a general rate increase most of the others followed suit. If you will turn to Appendix 3, however, you will notice that there are two carriers in our sample--both offering exclusively bellyhold service--which have taken only one general rate increase in the past two years. Another two carriers, one with some all-cargo capacity and the other with exclusively bellyhold service, have increased their rates just twice. One combination carrier which offers all-cargo as well as lower-deck service, has taken three general rate hikes; and a major all-cargo operator has taken four general increases since deregulation, the last two specifically pegged to fuel costs.

With respect to structural changes in rate levels, some carriers have introduced substantial (general freight) discounts on containerized and daylight traffic, and many are beginning to experiment with a variety of new price/quality service options. There have also been some rather sharp rate increases for carriage of highly select traffic requiring specialized care or handling. In our view, with industry and market entry in the all-cargo sector now fully open, and as opportunities for profit continue to grow, there should be continually increasing pressure on new and incumbent carriers alike to keep rates at levels that are

reflective of efficient carrier operations. This is exactly what is happening in the passenger sector today where profit opportunities are greater.

In the context of rate actions, I must point out that since enactment of P. L. 95-163, many carriers have reduced the limits of their liability for freight loss and damage, and some have increased charges for shippers to obtain additional coverage. This, of course, has resulted in increased costs for shippers who do not choose (intentionally or unwittingly) to self-insure.

As one of the basic elements of air freight service, liability for freight loss and damage is built into a carrier's air cargo tariff structure. Although the proponents of air cargo deregulation did not specifically seek legislative relief from CAB tariff rules jurisdiction, we believe that in the long run shippers will be best served by a competitive system in which individual carriers are free to develop their own liability and claims rules consistent with the service quality and rates which they offer shippers. In this connection, it is noteworthy that Flying Tiger, one of the few carriers which have taken four general rate increases since deregulation also offers shippers greater liability coverage, lower excess valuation charges, and more comprehensive risk assumption than most of its competitors. Thus, while the Board mandated uniformity in liability and claims rules and practices prior to deregulation, marketplace forces have resulted in a wide range of available coverages. Appendix 4 graphically illustrates this point.

Although a few shipper groups have expressed dissatisfaction with the turn of events since enactment of P. L. 95-163, the shipping public as a whole is clearly moving sharply increased volumes of freight by air. This tends to indicate that the industry is, in fact, successfully adjusting to the market forces of supply and demand, and that the benefits to shippers in the form of improved service options generally outweigh any problems relating to prices, tariffs, and liability coverage.

In 1978, scheduled freight revenue ton miles operated by the domestic trunk and all-cargo carriers exceeded the prior year's level by 12 percent overall and 27 percent in the all-cargo sector. This compares with growth of only 8 percent overall and 10 percent in the all-cargo sector in 1977. These figures are detailed in Appendix 5. As I mentioned before, all-cargo capacity, measured in available ton miles, was up 21 percent in 1978. And as you can see in Appendix 6, load factors on all-cargo equipment were at record levels: 61 percent overall, 65 percent for the all-cargo carriers, and 58 percent for the freighter services operated by the trunks.

Significantly, record traffic growth was not confined to the larger certificated trunkline and all-cargo carriers. Tonnage shipped by the all-cargo commuters, such as Federal Express, increased by almost 34 percent during 1978 compared with 29 percent growth in 1977. Broadly speaking, the domestic air cargo industry today is more competitive and more responsive to the public need than it was in the years prior to deregulation. Incumbent carriers are enjoying increased opportunities for market expansion and profit, and hence for additional capital investment. Due to certain transitional barriers to entry, we expect

another two to three years to pass before new entrants can make any substantial impact in the marketplace. Overall, however, the industry is already well on its way to revitalization, and we must tentatively judge the air cargo legislation a success. For the record, we are also submitting a copy of DOT's June 15 interim report on the initial results of air cargo deregulation.

With regard to airline passenger deregulation, I want to start with my conclusion: deregulation has been a success. Most developments are quite positive, and consumers, communities, and airlines all have benefitted. There are a few problems--some anticipated, some not--but none that would shake our confidence in the reform that has been accomplished.

Relaxation of airline economic regulation is still progressing, so that we will certainly see more changes as time goes on. Besides the dynamics of continuing regulatory change, there have been many external events--steep fuel price increases and fuel shortages, a shortage of aircraft capacity, a strike against a major carrier, and the grounding of the DC-10, to name a few--that are putting airline managements to the test and affecting industry performance. While these events complicate an assessment of deregulation, the airlines now have much greater flexibility to respond to such sudden and potentially disruptive events.

My comments on the effects of passenger deregulation fall easily into three topics: the effect on service availability, on fares, and on the airlines themselves. I will briefly summarize my remarks before moving on to a more detailed discussion.

With regard to availability of passenger service, frequency of service has increased and that is good for consumers, passengers, and shippers whose goods move on passenger aircraft. There are more flights available to more places passengers want to go, and where cargo needs to move.

Between April 1978 and April 1979, overall airline service to communities of all sizes in the 48 contiguous states increased 8.9 percent as measured by the number of departures. Medium-sized hubs gained the most overall service while small hubs gained the least. Another interesting statistic, relating to small communities, is that between the same dates service from nonhub points to hub cities increased from 4 to 4.5 percent. That means more flights were offered to residents of small communities to airports where they could make connections on many flights to points throughout this country and the world.

Measured another way, U. S. trunk carriers were operating 7.6 percent more nonstop city-pair services by the end of April 1979 than they were a year ago. Under the dormant authority provision of the Airline Deregulation Act, 294 city-pair markets received new airline service by certificated carriers and another 56 by other carriers. Thirty-three new routes were added under the automatic entry provisions. By way of multiple permissive route awards granted by the CAB previous to the Act and officially sanctioned by it, more than 2,000 authorities for service were granted. Service was inaugurated to 10 city-pairs during the first quarter of this year and another 16 city-pair markets were scheduled to receive new service by the end of the second quarter. One carrier, Braniff International, has virtually doubled its route miles since the first of the year, and increased its capacity by a half.

In addition, new competitors have entered major interstate markets. More than a dozen carriers have been certificated to provide interstate scheduled passenger service. Carriers formerly restricted to intrastate and charter services--Air Florida, PSA, Air California, Southwest, and World--are using large jet equipment to provide increased competition in major interstate markets.

Mr. Chairman, we at the Department are aware that there are some cities that have experienced significant reductions in flight frequencies. There were roughly 152 cities that experienced a 10 percent or greater decrease in frequencies in April of this year versus April of last year. Many of these were cities with already low levels of service and cities that were not on a carrier certificate.

The reduction in service, I understand, is especially distressing to communities that experienced drastic reductions in service and, unlike cities that lose all certificated service, are not eligible for essential air transportation. While I sympathize with these cities, I do not see that the situation calls for faulting the Airline Deregulation Act or seeking legislative changes. True, the Act has made it easier for airlines to exit markets. But even under the old rules carriers dropped a substantial number of cities from their system. It is also true that the opening of new routes under liberalized entry provisions--including dormant route authority--was an inducement for airlines to shift services to markets that have a promise of greater profitability. But it is also true that we are in a period where airline capacity is in short supply relative to traffic levels and the carriers understandably want to deploy their equipment where it can be most

productive. This strain on capacity could not have been foreseen when the Act was drawn up. Also to be considered is the fact that the previous reluctance of the CAB to award new routes so bottled up the industry and prevented the industry from making needed changes that when regulations were freed extensive adjustments were made in a short period of time. I am confident that as opportunities are recognized by other carriers, particularly commuters, they will fill the void left by exiting carriers and most cities will have better service than they have had in the past.

As the CAB continues to make progress in the administration of the essential air service program, the cities that are eligible will find that the program does protect them. It is the intention of the Department to make sure Section 419 succeeds as Congress and the President intended. The Department continues to take an active interest in the implementation of Section 419. We participated in the CAB regional hearings on the subject that were held earlier this year, and filed comments with the CAB on their draft regulations on essential air service.

The greater availability of low fares has been a truly impressive and beneficial development. Almost 48 percent of the coach passengers using airline service today are flying at reduced rates because of the wide availability of discount fares. Recent competitive pressures have led airlines to reduce the number of restrictions associated with these discount fares, making them even more usable than they were in 1977 and 1978 when they were progressively introduced throughout the system.

The availability of discount fares has saved consumers millions of dollars. The Civil Aeronautics Board estimates that passenger savings (including international passengers) have amounted to \$2.5 billion since March 1977. For consumers, air travel is still a real bargain. Using 1968 constant dollars, the Consumer Price Index has increased 100.9 percent, halving the worth of the public's dollar, while average air fares have only increased 49.6 percent. In 1978, the Consumer Price Index rose eight percent, while average fares dropped more than two percent. This is a great accomplishment.

This switch from a quite restricted and inflexible fare structure to a more competitive pricing system has proven without question that there is considerable elasticity in the airline passenger market. Domestic revenue passenger-miles of the trunk and local service carriers increased 16.7 percent in 1978. These large increases have continued in 1979. Because of the enormous traffic increases during the last half of 1978, the percentage increases are not expected to look quite as impressive during the second half of this year. But ATA does expect a 10 percent increase in system traffic for 1979. Domestic trunk load factors increased from 55.9 percent in 1977 to 61.2 percent in 1978, greatly increasing the productivity of aircraft operations.

There is also some evidence that airlines are beginning to price their services on a market-by-market basis. Carriers entering new markets are offering lower fares to gain market share and identity. The new fare flexibility is allowing airline management to tailor fares to attain their desired position in a market. Specific examples of this are Air Florida's fares in the Washington-Miami

market, which were less than half of the economy fares offered by market incumbents. Another example is Texas International's introductory fare for its new services from Baltimore to Texas, Las Vegas, and Los Angeles, which ranged from 45 to 54 percent off normal fares.

As airlines move into new markets, the consumer benefits from lower fares as well as new services. The pressure of possible new entry from still other carriers should keep fares at generally lower levels.

As for the airlines, deregulation has brought them a variety of advantages. Besides the increased traffic and profits that have been gained through discount fares and system rationalization, airline managements no longer need to spend time making plans to get around cumbersome regulatory restrictions. As United's Chairman Richard J. Ferris said in a recent speech: "In terms of corporate planning, United spent a lot of time planning its way out from under CAB regulations Route planning can now be an orderly business process. Now, airline decisions about which market to serve can be like those of other American companies. Choices about business location can now be made by airline managements."

Besides this new ability to plan their route system effectively, without CAB denials of route applications or regulatory lag, the airlines have been able to move toward a more efficient hub/spoke system of service instead of the inefficient, multistop system of the past. Establishing new hubs has resulted in moving some collection/connecting flights from congested airports, thereby

increasing efficiency as well as passenger convenience. Also, some carriers are moving to remove seasonal imbalances from their route structures by acquiring counterseasonal routes.

The pricing flexibility made possible by deregulation has allowed carriers to keep better pace with their cost increases instead of experiencing the painful losses forced on them by regulatory lag and Domestic Passenger Fare Investigation rules. Costs for airlines, as for other businesses in this country that have a heavy dependency on petroleum products, are rising at a meteoric rate. Since the first of the year, average jet fuel prices paid by airlines have skyrocketed, and are expected to continue upward. Overall expenses for U. S. airlines were up 16 percent for the first half of the year over the first half of 1978, and it is anticipated that they will increase another 26 percent for the second half of 1979 compared to the second half of 1978.

Carriers have moved quickly under the liberalized provisions of the Act to put fare increases into effect to cover these rising costs. Despite the rising costs, it is expected the trunk airlines will post an industry profit of at least \$500 million for the year. Profits were much lower than \$500 million in 1974 and 1975 (a loss year) when the first round of steep fuel price increase occurred along with an economic recession.

It is interesting to compare concerns expressed when the deregulation debate was at its height to what has actually happened. Some said deregulation would cause a number of bankruptcies among the financially weakest carriers. This has not occurred and, in fact, these weaker carriers have strengthened their financial positions.

Some said deregulation would cause bigger carriers to gobble up smaller carriers. Some predicted that given the chance, United would make sweeping moves against all carriers. In fact, United has not attempted to gobble up the Nation's route structure as is evidenced by its filing for only a single dormant authority point. Between March 1978 and March 1979, United's share of the total domestic revenue passenger-miles increased 1.6 percentage points, and this has been accomplished mostly through increases in aircraft utilization and schedule changes rather than massive expansion of routes.

Some also said that deregulation would return the industry to the dog-eat-dog atmosphere of preregulation days. That has not happened either. Airlines have not behaved in a predatory manner, and there are no indications they will begin doing so.

At this point, I want to touch on a problem that affects the industry's ability to provide new service. The increase in flights at major congested airports has in some cases swamped both operational and terminal capacity.

At airports where the access is controlled by the airport manager, or the operations are allocated by an airline slot committee, it has been difficult for new carriers to obtain landing space. Likewise, there has been a lack of gates and counter space. Environmental considerations are also a factor. This has been a particularly pressing problem when essential air service is to be provided by a new carrier and it cannot operate into the hub because of such space limitations. The FAA and CAB have been successfully working out such problems as they develop. In DOT's view, carriers should not be precluded from developing and

maintaining new services by insufficient landing and terminal space. To that end, the Administration has proposed in the ADAP renewal legislation that the Secretary of Transportation be given the authority to establish regulations to allocate slots at airports for reasons of safety, efficiency in airspace management, and alleviation of congestion. The Secretary would take such action only when the parties involved cannot reach agreement. Also, the FAA is pioneering an experiment at Washington National Airport to determine whether separate landing patterns for commuter aircraft are feasible. The DOT will continue to monitor the effects of airport congestion and to take whatever action is appropriate to find solutions to these problems. We are determined not to let these problems impair the implementation of the Act.

I want to conclude my testimony with a few remarks on mergers. One of the fears expressed with regard to deregulation is that the industry will in the future be composed of a small number of very large carriers because dominant ones will attempt to coopt their competitors and those that have less economic power combine their forces for defense against carriers perceived to be presenting a competitive danger. I do not believe this will occur. The requirement that each proposed merger be evaluated and antitrust laws will guard against any mergers that unduly restrict competition.

Of the half dozen mergers that have been proposed or completed since the passage of the Act, there are many more factors than fear of competition prompting them, including a good bargain in assets (principally aircraft) that are undervalued in stock prices and, in the case of Pan Am, acquiring a domestic

system at one stroke. Also, I note again that large carriers have not shown any signs of predatory behavior designed to weaken other carriers that could then become a takeover target. United was perhaps the most feared carrier, and it has chosen to be rather conservative in route expansion efforts. The process of continuing competition from relatively smaller carriers expanding into larger routes, as we have recently seen in the case of large intrastate and supplemental carriers, will be a check on increased concentration. DOT has taken and will continue to take an active interest in merger activity, supporting or opposing proposed mergers according to their likely anticompetitive effects.

Mr. Chairman, this ends my prepared remarks. I will be happy to answer any questions.

